Arrest of Maritime Property – Mechanics and Emergencies

Marc D. Isaacs

Isaacs & Company, Toronto, ON

National Judicial Institute/Canadian Maritime Law Association Joint Seminar in Maritime Law

Ottawa, April 15, 2011

Arrest and Sale of Maritime Property: The Mechanics and the Emergencies

Part II – Sale

by Marc D. Isaacs[†]

The first paper in this series addressed the issues that can arise from the time of arresting maritime property up until the point of trial. This paper is about sale of the arrested property. In particular, I will examine the framework by which the Court can order the sale of the arrested property *pendente lite*, and the mechanics of a court ordered sale pursuant to the Court's admiralty jurisdiction. In conclusion, I will also briefly address the concepts of priority on a sale and wrongful arrest.

I. SALE *PENDENTE LITE*

The early release of arrested property (consensually or otherwise) facilitates maritime commerce, which is the cornerstone value of admiralty law. Customarily, property that is subject to maritime arrest is released from arrest by way of bail or other form of security. Thus, the bail/security replaces the arrested property and there is no need to go further in terms of sales or other issues, with the possible exception of priority to the proceeds of sale.

However, in some situations, the owner of the arrested property does not provide bail or other security to enable the release of the maritime property. The arrested property then remains under the jurisdiction of the court until the dispute is resolved. Following adjudication, the property can be ordered sold to meet the claims leading up to the arrest. In rare cases, the arresting party (or others) may seek to have the maritime property sold before the final determination of the case on its merits. In those situations the Court, pursuant to Rule 490(1) of the *Federal Courts Rules*, has the power to order a sale before judgment or "*pendente lite*".

In particular, Rule 490(1) provides that the court may order, in respect of property under arrest, that "where the property is deteriorating in value, it be sold forthwith."[1] While such a power applies to both cargo and vessels, both being property that is capable of being arrested, the disputes and case law surround the applications for sale of vessels, which will be the focus in this paper. The principles relating to the sale of vessels are equally transferrable to sale of the cargo, if not more so, particularly where the cargo is perishable or there is a deteriorating market for the commodity.[2]

[†] Isaacs & Co. Toronto, Canada. I must gratefully acknowledge the assistance of my associate, Bonnie Huen, for her hard-work, research and assistance in writing this article.

[1] *Federal Courts Rules* ("FCR" or simply "Rule"), Rule 490(1) (f)

[2] Rule 490 (1) (f) & (h).

The Benchmark English Decision: *The "Myrto"*

The first Canadian decision to consider the principles of sale of arrested property *pendente lite* is *The* "*Alexandros G. Tsavliras*"[3]. In that case, the Honourable Mr. Justice Collier was faced with a motion for an order that the vessel "Alexandros G. Tsavaliris" be sold before trial and judgment. Justice Collier noted that there were no decisions in which the Federal Court had considered the applicable principles for sale *pendente lite*, and found that the considerations set out in an1977 English Admiralty Court case, *The "Myrto*"[4], were relevant and applicable.

The "Myrto" has found its way into subsequent Canadian decisions on the issue of sale *pendente lite*, and it is worthwhile to review the foundational decision. In *The "Myrto"*, two applications were before Justice Brandon: One by the bank (holders of two mortgages on the vessel) for appraisal and sale before judgment and the other by a charterer for release of the vessel. The bank sought sale of the ship *pendente lite* on the grounds that the vessel was a wasting asset while under arrest, and that such a sale was in the interest of all parties.

Justice Brandon noted that the question of whether a ship under arrest should be sold *pendente lite* normally only arises where there is a default of appearance or defence. This is because defendants that intend to defend "almost invariably obtain the release of the ship from arrest by giving bail or providing other security for the claim satisfactory to the plaintiffs." In The "Myrto" however, the defendants had made no such offer. We will see that this is a recurring theme in motions for appraisal and sale *pendente lite*; it is often when a defendant fails or refuses to provide security for the vessel that a plaintiff will move for an order for sale before the litigation is concluded.

In deciding that it was an appropriate case for sale *pendente lite*, the Court made the following comments:

> On the assumption that the action will remain contested and proceeded to trial, such trial would, unless expedited, be unlikely to come on for about years 1 ½ years. Even if the trial was expedited, I doubt if it would come on in much less than seven months, that is to say some time after the long vacation this year… It follows that the continuing costs of maintenance which have to be considered are costs over a period of at least seven months, during which some costs of maintenance will also have to be incurred if physical deterioration of the ship is to be avoided.
>
> I accept that the Court should not make an order for the appraisement and sale of a ship pendente lite except for good reason, and this whether the action is defended or not, I accept further that, where the action is defended

[3] *Branco Do Brasil S.A. v. Alexandros G. Tsavliris (The),* (1987) 12 F.T.R. 278
[4] [1977] 2 Lloyd's Rep. 243

> and the defendants oppose the making of such an order, the Court should examine more critically than it would normally do in a default action the question whether good reason exists or not. I do not accept, however, the contention put forward for the owners, that the circumstance that, unless a sale is ordered and continuing costs of maintaining the arrest will be incurred over a long period, with consequent substantial dimunition in the value of the plaintiffs' security for their claim, cannot, as a matter of law, constitute a good reason for ordering a sale. On the contrary, I am of the opinion that it can and often will do so.
>
> …
>
> It would, in my view, be unreasonable to keep the ship under arrest at great expense for seven months or more, with the result that, if the bank suceeeded in their claim, the amount of their recovery would be reduced by the costs incurred.[5]

In short, the court considered the following factors to establish that there was "good reason" in that case for sale *pendente lite*:

1. That it would be at least 7 months until a final determination was made, and meanwhile, the bank (who originally arrested the vessel due to a mortgage default) was incurring the charges for maintaining the arrest including berth charges, crews' wages, supply of oil bunkers; supply of water; supply of food and other necessaries and insurance;
2. Ongoing maintenance costs would have to be incurred to avoid physical deterioration of the ship; and
3. As a result, the plaintiff's security for its claim would be diminished.

Notably, the Court expressly stated that continuing costs of maintenance incurred over a long period and the consequent diminution in value of the vessel often constitutes a good reason for ordering a sale[6]. This has become one of the major factors considered by Canadian Courts in the analysis of a request for sale *pendente lite*.

[5] *Supra* note 4 at p. 260-261
[6] *Supra* note 4 at p. 260

The Test for Sale *Pendente Lite*: *The "Karey T"*

An application of *The "Myrto"* principles was undertaken by Prothonotary Hargrave in a decision in 1994: *The "Karey T"*[7]. In *The "Karey T"*, Prothonotary Hargrave extracted the elements considered by the Courts in *The "Myrto"* and *The "Alexandros G. Tsavliris"*, and conveniently enumerated them as follows:

1. The value of the vessel compared with the amount of the claim;
2. Whether there is an arguable defence;
3. Can the owner carry on: is it reasonable to assume that there must be a sale of the vessel at some point;
4. Whether there will be any diminution in the value of the vessel or of the sale price by the delay, including the cost of keeping a man or a crew aboard the vessel, the cost of maintaining the vessel and the cost of insuring the vessel;
5. Whether the vessel will depreciate by further delay;
6. Whether there is any good reason for a sale before trial.

The "Karey T" was a 38 foot wooden fishing vessel which had collided with another fishing boat. The "Karey T" was subsequently arrested, bail was set but no bail was posted. Prothonotary Hargrave applied the factors he had enumerated to the facts at hand and ordered sale of the vessel in considering the following:

1. The affidavit evidence suggested that the value of the "Karey T" was about $60,000.00. The amount of bail was set at $42,000.00;
2. The defendant had admitted liability so whether there was an arguable defence was not a factor (the "Karey T" struck an anchored vessel);
3. The defendant was unable to raise satisfactory bail despite having use of the "Karey T" for the 1993 and (a substantial part of) the 1994 salmon fishing season, or through the vessel's insurers. Notably, Prothonotary Hargrave stated that "the inability to post security is an indication that when the amount of damages is determined, the vessel will probably have to be sold in order to pay those damages"[8];
4. There would be a diminution in value of the vessel during the time it took to solve the damages issue;
5. The "Karey T" was an older vessel, and if uncared for, would tend to depreciate rapidly;
6. Other reasons for sale before trial:
    - The "Karey T" had a fishing license and there nothing to prevent the defendant from selling and transferring the licence to another vessel;
    - The defendant moved the vessel despite a court order not to do so;
    - The plaintiff only required a determination of damages, and the sale of the vessel would secure a fund against which to satisfy damages.

[7] *Brotchie v. Karey T (The)*, [1994] F.C.J. No. 1266
[8] *Supra* note 7 at para. 22

Prothonotary Hargrave commented that sale pending completion of litigation is "a fairly drastic measure."[9] However, we will see that there are quite a few instances where sale *pendente lite* is appropriate, and in fact, not so uncommon and need not necessarily be considered drastic as opposed to pragmatic in the right circumstances.

The "Western Horizon"

In 1996, Prothonotary Hargrave again revisited the issue of sale *pendente lite* in *Canada (Minister of Supply and Services) v. Horizons Unbound Rehabilitation and Training Society* (*The"Western Horizon"*)[10]. The defendant was a society dedicated to the rehabilitation of young offenders through shipboard training programs. In 1990, the defendant had obtained a 177 foot surplus trawler-rigger vessel from the Ministry of Supply and Services for one dollar, in return for various undertakings such as agreeing to refit the vessel to acceptable standards so as to be ready for its intended operation within eighteen months. These undertakings were enforced as part of an agreement collateral to a marine mortgage in favour of the Crown.

The undertakings were not upheld and the Crown (plaintiff) moved to sell the vessel *pendente lite* on the grounds of deterioration of the vessel and the ongoing cost of moorage. Prothonotary Hargrave set out the judicial history of the test for sale *pendente lite*, tracing its development from *The "Myrto"* up until his prior decision in *The "Karey T"*. He applied the factors set out in *The "Karey T"*, while bearing in mind the tenet that "a court ought not easily interfere between mortgagor and mortgagee so as to deprive a mortgagee of in hand security"[11], (the in hand security being the vessel):

1. The Western Horizon may fetch $60,000.00 on sale but it carried a $200,000.00 mortgage, and the defendant shipowner did not have substantial equity in the ship;
2. The submissions on behalf of the defendant raised arguable defences;
3. The ability of the defendant to carry on the project was questionable, and may well dictate a sale of the vessel at some point;
4. There would be diminution in value of the vessel by reason of ongoing moorage costs, which is a substantial ongoing cost;
5. There was evidence that the vessel was deteriorating;
6. Prothonotary Hargrave expressed that the "final and deciding issue" was whether there is any good reason for sale before trial. He concluded that there were four main reasons:
    i. Ongoing cost of moorage, which could result in a moorage bill in excess of the value of the vessel by the time trial is completed
    ii. Ongoing depreciation

[9] *Supra* note 7 at para. 10
[10] [1996] F.C.J. No. 1496
[11] *Supra* note 10 at para 31.

iii. Owner had no equity in the vessel
iv. Owner had not offered to share moorage, or to maintain the vessel, or put up value of vessel as security

As we can see, the Court considered the crucial factor as noted in The *"Myrto"* that continuing costs of maintenance (in this case, moorage alone) would result in the consequent diminution in value of the vessel as a good reason for ordering the sale.

The "Essington II"

In 2005, Prothonotary Hargrave issued another decision for sale *pendente lite* in *Franklin Lumber v. Essington II (The)* (*The "Essington II*")[12]. The "Essington II" was a former federal Public Works vessel measuring 119 feet in length with a 16 ton crane permanently mounted on the foredeck. The vessel was owned by the Defendant Bullco Pile & Dredge Ltd. ("Bullco") who had had the vessel up for sale for many years, but without success. At the time of the decision, there was a seriously interested buyer. The plaintiff, who held a marine mortgage over the vessel, desired that the sale of the "Essington II" take place, but the plaintiff and Bullco could not agree upon division of sale proceeds. Bullco took the position that the ship was in fine condition and was content to have it sit idle until the litigation came to an end. Again, Prothonotary Hargrave considered each of the elements enumerated in The *"Karey T"* in the context of the "Essington II":

1. $380,000 was a reasonable market value for the vessel. The claims against the Essington II exceeded "even the most optimistic valuation of the vessel"[13];
2. The pleadings did not disclose an arguable defence;
3. In face of the balance of the claims, it was doubtful that Bullco can carry on and avoid a sale;
4. The value of the vessel continued to diminish, both in real terms by reason of deterioration and on paper, by reason of moorage and the cost of keeping an eye on the vessel, together with ongoing interest expenses;
5. Other reasons:
    - After seven or eight years of advertising there is a ready, able and willing buyer, prepared to pay a reasonable price.
    - The Essington II was uninsured (no hull and machinery insurance)

[12] 2005 FC 95, [2005] F.C.J. No. 125
[13] *Supra* note 12 at para. 55

General Principles: Good Reason and Fairness

While Justice Brandon stated in *The "Myrto"* that "the Court should not make an order for the appraisement and sale of a ship *pendente lite* except for good reason,"[14] it appears that there often is very good reason for such a sale when a ship has been properly arrested and no security has been offered by the shipowner. This is because a vessel is a unique form of property which often calls for great expenditure in its maintenance, moorage and upkeep. A vessel, unless it is in operation and generating income, is more often than not a "sinking ship" of expenses.

The Courts, starting from the decision in *The "Myrto"*, have firmly accepted that the heavy and continuing costs of maintenance incurred over a long period, and the consequent diminution in value of the vessel, is often a good reason for ordering a sale. In practical terms, once the moving party establishes that the costs of maintaining the vessel under arrest is likely to constitute a significant amount in relation to the vessel's worth (and any potential recovery)[15], it is up to the opposing party to present evidence as to why a sale *pendente lite* ought not to take place.

It has been held by some decisions that an important factor is the relationship between the vessel's value and the claim and ongoing costs. However, it is suggested by the author that the ratio between the value of the vessel, the value of maintaining it until disposition and the value of the claim ought not be determinative, and lesser weight should be placed on this criterion. Although the value of the claim may be small when compared to the value of the vessel, it stands to reason that the owners would either arrange for bail in order to work the asset (and avoid needless unproductive costs of the vessel sitting idle while under arrest) or they are unable to do so because of dire financial circumstances making the sale of the vessel an inevitability.

Another overarching concern of the court is that of fairness. The test as enumerated and applied by Prothonotary Hargrave serves to balance the interests of both the plaintiff and the defendant. It is often after a defendant has failed to post bail or to make payments in relation to the maintenance of the vessel that the plaintiff will move for sale *pendente lite*. At this point, the defendant has had an opportunity to avoid the sale by posting security. If the claim arises due to collision, allision, injury, cargo damage or similar cause then such losses ought to be insured and the vessel's insurers will customarily arrange for the posting of security and release of the vessel. If the claim arises out of an unpaid account or mortgage default, or the vessel is uninsured, then it is a sign that the owner is financially distressed and a sale is inevitable. It is therefore submitted that it is up to the defendant to convince the Court as to why the sale should not proceed in light of their failure to provide security. For example, in *The "Karey T"*, the

[14] *Supra* note 4 at p. 260

[15] *International Marine Banking Co. v. Dora [No. 2] (The)*, [1977] 1 F.C. 603, is an example where the Court was not satisfied, based on the evidence, that the expenses for maintaining the vessel under arrest were exceptional in proportion to its size and value. Associate Chief Justice Thurlow stated, at para. 10: "The vessel is big, the investment which she represents is large and the expenses and losses are large in proportion. That is all that is unusual about them."

defendant's counsel urged sympathy for the defendant in that the sale of the fishing vessel would put the defendant out of business. In response, the Prothonotary noted that:

> …one must not lose sight of the harm done to the Plaintiff who apparently, through no fault on his part, was put out of business for a part of the 1993 salmon season and who still remains out of pocket and unsecured.[16]

Indeed, the defendant had been given an opportunity to raise satisfactory bail for over a year but had failed to do so. The remedy of sale *pendente lite* was not a penalty against the defendant, but rather aimed at securing a fund for the plaintiff against which to satisfy its damages. The Court must balance the interests of both plaintiff and defendant, given the particular circumstances of the case. In particular, a plaintiff that seeks to acquire security for its claim should not have his ability to obtain security ultimately frustrated by recalcitrant defendants or other delays in adjudication which may be no fault of the plaintiff creditor.

In some cases, the court will extend consideration to the interests of those not party to the lawsuit to achieve a fair result. For example, in *The "Essington II"*, Prothonotary Hargrave stated:

> A most telling reason why a sale ought to take place now is that the Essington II is uninsured. There may be some liability insurance, should Saltstream Engineering Ltd. be found liable for any damage done by the Essington II which is tied at Saltstream's facility, but there is no evidence of any hull and machinery insurance on the vessel for damage to the vessel. Bullco says this is not relevant in that Franklin, at one point, recognized that the vessel was uninsured, but clearly that is not Franklin's position now. Moreover, the vessel ought to be insured to protect the position of others interested in the vessel. Further, and this is a public policy issue, the Essington II ought to be insured to protect taxpayers against the substantial expense which would be incurred should the Essington II sink: here I have in mind both pollution clean-up and wreck removal.[17]

The Prothonotary viewed the lack of insurance not only as a threat to the vessel but as a "public policy issue". This kind of consideration gives an idea as to the flexibility of the "good reason" analysis is for sale *pendente lite*.

Taking from Prothonotary Hargraves' comments in *The "Essington II"* about "a public policy issue", the author submits that public policy is also a valid reason to consider in ordering a sale *pendente lite*. A public policy concern could come in many different forms, such as the vessel may present undue risk in terms of environmental damage if it sinks or leaks its berth, it may tie up space in overcrowded dockyards or ship repair facilities or it may be a drain on resources

[16] *Supra* note 7 at para. 28
[17] *Supra* note 12 at para. 60

(both public and private) to maintain the vessel under arrest awaiting sale. These concerns could be obviated by putting the vessel into the hands of persons that could work the vessel.

The goals of maritime law, historically, have been to promote maritime commerce and facilitate the trade of goods and the movement of vessels. A vessel is an income earning asset. It makes little sense from a macro-economic perspective or at the policy level to have an income producing asset sit idle while that same asset could be gainfully employed in the hands of others. Likewise, a vessel is a resource consuming asset as it consumes fuels, lubricating oil, crew time and dock space, all of which could be better used by trading vessels who are actively engaged in maritime commence. Accordingly, the author suggests that a sale of a vessel *pendente lite* need not be viewed as a drastic measure, but in many cases as a pragmatic solution to manage a costly problem.

Conclusion

The test for sale *pendente lite* must afford some degree of flexibility as each proposed sale must be assessed on a case-by-case basis with the principles of good reason and fairness as a guide. However, the Court should not hesitate to order a sale if there is evidence that the financial situation of all parties will be made worse by a delay in the sale of the vessel.

In conclusion, the evaluation of a request for an order for the sale of arrested maritime property *pendente lite* centers on good reason and fairness. The principles and issues to consider include (in no particular order):

1. Why has the defendant failed or refused to provide bail or security for the vessel?

    a. Is it because the owners have failed to insure the vessel for potential liabilities in keeping with customary maritime practice or violated its insurance cover?

    b. Is it because the defendant is in a difficult financial situation where it is no longer able to meet its obligations as they come due?

2. What is the cost of maintaining the vessel while under arrest?

    a. The costs of keeping the vessel at her present location (berthage, ship-keeper etc.)

    b. The costs of on-going maintenance to prevent deterioration of the vessel's value

    c. Can the owner maintain these costs?

3. Who is paying for the expenses while the vessel is under arrest, the owner or another party?

4. Is the value of the vessel deteriorating?

    a. Is there an offer to buy the vessel?

    b. Is there a market for the vessel?

    c. Where is the market for the vessel headed?

5. How long will it take until determination of the claim?

6. Will the plaintiff's overall security be diminished or frustrated by ongoing expenses?

7. Is the sale of the vessel inevitable?

8. Is the vessel adequately insured and will it remain so during the course of the arrest?

9. The value of the vessel compared with the amount of the claim;

10. Is there an arguable defence to the claim;

11. Are there other good reasons or public policy reasons for the sale of the vessel?

    a. Concern over environmental or wreck removal liabilities
    b. Better economic use of the assets involved?

12. Will sale of the vessel facilitate maritime commerce?
13. Will any party's economic position worsen by not selling the vessel?

II. THE MECHANICS OF AN ADMIRALTY SALE

Sale of arrested maritime property is governed by Rule 490 of the *Federal Courts Rules*. The Rule applies whether the property is sold *pendente lite* or following final adjudication. Rule 490 provides the Court with broad discretion and powers in relation to sale of the arrested property. The property may be appraised and sold or sold without appraisal. It may be sold by public auction or by private contract. It may be sold with or without advertisement. How then does the Court decide upon an appropriate order for a judicial sale or arrested property?

Generally, the Court will and should provide for some sort of formal appraisal and advertisement, as was the traditional rule in admiralty practice. However, the Courts have powers to order otherwise, as specifically provided by Rule 490. There are as many different options as there are situations.

Fair market value, attracting the best price and the lowest transaction cost

While the terms and mechanics for the sale of a ship are discretionary and depend on the particular circumstances of each case, there are certain standards and rules that have guided the Courts consideration in ordering the sale of a vessel.

The "Essington II" (discussed above) is a good example where the court gives consideration to some of the key factors in ordering the conduct of a sale: That the vessel (i) be sold for fair market value; (ii) have an opportunity to attract the best price; and (iii) that the best price be obtained with the lowest transaction cost.

In *The "Essington II"*, Prothonotary Hargrave found that it was appropriate to sell the Essington II privately and without formal court ordered appraisal. The Prothonotary considered the decision of *Sea-Tec Fabricators Ltd. v. Offshore Fishing Co. Ltd.*[18], where Mr. Justice Walsh stated the standard to be applied in ordering a private sale without advertising and appraisal as follows:

> …this is an order which should only be given if it is clear that no greater amount could in any circumstances be realized by a sale by public auction after advertisement, without any appraisal having been made, which would give some indication to the Court of the value of the vessel.[19] [Emphasis added]

The fact that there was a serious buyer after seven to eight years leading up to the litigation factored into Prothonotary Hargrave's analysis of dispensing with a court ordered sale:

[18] [1985] F.C.J. 236
[19] *Supra* note 18, at para 6., quoted in *The Essington II* at para. 47

> In this instance there is some urgency in deciding whether or not to sell the Essginton II on an expedited basis, for the intended buyer, Mr. Doswell, is the only serious buyer in seven or eight years, indeed a buyer to be seriously considered. Mr. Doswell clearly has better things to do than wait on the lengthy process on a court ordered sale, including a whole panoply of advertising, appraising, waiting and bidding. Mr. Doswell has a pending contract for employment of the Essington II, a ship which Mr. Smeal believes he cannot afford to operate. Mr. Doswell needs certainty at an early date.[20]

It comes as no surprise that the Court would consider 7-8 years as ample opportunity for the vessel to attract the best possible price. In fact, if the Court was to order for sale in accordance with the traditional rule of advertising and auction, the "serious buyer" may no longer be interested in the purchase, thereby jeopardizing the chance of any sale at all.

Counsel for the defendant submitted that the vessel may potentially have greater value in the future on the basis of a rejuvenated fish farming industry or an offshore oil development. The Prothonotary considered these two arguments and concluded as follows:

> Given all of the circumstances it is clear that no greater value could, in any circumstances either now or in the immediate future, be realized at a public auction after advertisement and with a sealed appraisal having been lodged with the Court… In short, I am satisfied that a price of $380,000 is a fair market value for the Essington II.[21]

It is suggested that once the plaintiff can present satisfactory evidence to the Court, by way of appraisals or otherwise, that the purchase price procured represents fair market value, the Court should be satisfied that no court ordered appraisal is necessary. In order for a defendant to insist upon a court-ordered appraisal and advertisement be mandated as per the traditional practice, the defendant must establish that those measures are necessary and that the vessel would not be sold at fair market value otherwise.[22]

Fairness and the Appearance of Fairness

A Court ordered sale has "a view to the protection of the interests of all parties."[23] A party cannot submit to the Court a sale arrangement intended to suit its own purposes and request the endorsement by the court of that private arrangement. The sale is for the benefit of all parties,

[20] *Supra* note 12 at para. 43
[21] *Supra* note 12 at para. 49.
[22] See *Nordea Bank Norge ASA v. Kinguk (The),* [2006] F.C.J. No. 1670 at para. 6
[23] *International Marine Banking Co. v. Dora [No. 2] (The),* [1977] 1 F.C. 603 at para. 7

including the owner and others that may not have arrested but have an interest in the vessel and its sale.

In *The "Dora"*[24], the plaintiff applied for sale of the "Dora", a motor tanker of about 95,000 dead-weight tons, by private contract. The plaintiff put forth the usual arguments that the expenses for maintenance were accruing and that the vessel could deteriorate without proper manning by an adequate crew. The plaintiff also submitted that the sale price of $5,900,000.00 offered by the potential buyer was the best obtainable and should be approved by the Court.

The Court examined the manner in which the sale price was arrived at. There was a one-week period allowed for inspection of the vessel and a twenty four hour period in which to submit offers. The Court commented that this alone may have accounted for the fact that several prospective buyers indicated that they were no longer prepared to continue negotiations when the demand for offers was made. The Court was not satisfied that the price of $5,900,000.00 was the best price, in light of affidavit evidence which supported that a higher price could reasonably be obtained and the procedures of sale. In other words, it was not clear to the Court that no greater amount could be realized.

Of significance are the comments made by the Court that even if it were satisfied that the price was of fair market value, it would not endorse the private sale:

> The fact of the matter, as I view it, is that the procedure is one prescribed by the plaintiff as satisfactory for its own purposes and the proposed sale which has resulted from it is not a sale by the Court at all but a sale by the plaintiff for which it now seeks the endorsement of the Court to give the transaction the appearance of a sale by the Court. I would not, therefore, be prepared to grant the order sought even if I were satisfied that the 5.9 million price is as high as any price likely to be obtained on a sale by the Court.[25]

This underscores the importance that terms and procedures of private sales be fair, and be seen to be fair, if it is the party's intention for the proposed sale terms to form part of a sale order.

[24] *International Marine Banking Co. v. Dora [No. 2] (The)*, [1977] 1 F.C. 603
[25] *Supra* note 24 at para. 17

Special Circumstances

Bank of Scotland v. Nel (The) (*The "Nel"*)[26] is another example where the Court endorsed the pre-arranged private sale of an arrested ship. While the Court considered the notion of fair market value, it was also concerned with the timing of the sale given the nature of the cargo that the vessel was carrying at the time of arrest.

The "Nel" was a bulk cargo and container ship loaded with 34,398 metric tonnes of bulk sulphur that was to be carried from Port Moody, British Columbia to Tunisia. The "Nel" was under siege by a number of creditors and was eventually arrested by the mortgagor, the Bank of Scotland and arrested a second time by another creditor.

The arrests meant that the transportation of the sulphur was stopped in its tracks. The Bank of Scotland was concerned about likely corrosion damage to the "Nel" should the sulphur remain on the vessel for too long. The possibility of off-loading the cargo at Vancouver was explored but this option would be very costly. As an alternative, the Bank considered a private sale of the "Nel" to a buyer that would carry the cargo to its destination.

The Buyer was prepared to pay US$5,000,000.00 for the "Nel". The Bank provided two valuations of the "Nel" prepared by ship brokers, one which estimated the vessel's market value at about US$4,000,000.00 and the other at US$3,750,000.00

Prothonotary Hargrave commented on the private sale as follows:

> A privately arranged sale is an understandable approach given the time it usually takes to complete a court ordered sale: in the present circumstances there would just not be time for a court ordered sale before the onset of the likely corrosion damage. The Bank of Scotland is acting rationally for the option of discharging the cargo, for the safety of the ship and to prevent contamination of cargo due to corrosion products, is, at some $1,300,000.00 (U.S.), an exceedingly unattractive option for all concerned.
>
> …
>
> In the present instance, the sale may well suit the Plaintiff's purposes, but there are also broader common purposes including the ability to obtain proper value for the vessel that is at present apparently seaworthy but if left for a number of weeks, to accomplish a court ordered sale, might develop corrosion damage, become suspect as to condition and seaworthiness and thus be difficult to sell at a good price. Moreover, any buyer would likely insist that the cargo be off-loaded, a large expense coming out of the sale price, for no knowledgeable buyer would be interested in a ship loaded with a cargo of sulphur three or four

[26] [1997] F.C.J. No. 1732

> months old or with trying to deliver that cargo by a voyage through a tropical or sub-tropical climate, with the prospect of adding to the corrosion damage which would almost certainly have begun. [27]

The Prothonotary recognized that the situation in this case was a "very special circumstance" which mandated an expeditious private sale. There would just not be enough time for a court ordered sale, as the "Nel" could incur corrosion damage in a number of weeks. The Prothonotary recognized that denial of such a sale would result in either substantial expense to remove the cargo and/or a substantially lower sale price of the vessel due to corrosion, either of which would result in less proceeds available to the creditors. The result would be contrary to a court ordered sale, which is to obtain the best fair price for the vessel.

Options on a Sale

As noted above, the *Federal Courts Rules* provide broad discretion and wide powers to the Court in the conduct of an admiralty sale. Every vessel is different and the circumstances leading up to the arrest and sale of a vessel are different. Accordingly, the Court, with the assistance of counsel where possible, should endeavour to craft a means of sale to achieve the objectives of selling the vessel for fair market value with the opportunity to attract the best price at the lowest transaction cost. The options available to the Court include:

- That the sale of the vessel be advertised in various trade or industry publications[28];
- That the sale be directed by the sheriff[29];
- That the sale be directed by a ship broker or other agent[30];
- That the offers be under sealed and are opened at the same time[31];
- That the sale not necessarily be to the highest bidder, or at all, if there are no satisfactory offers or if the Court believes that further and better offers could be obtained through another process[32]; and
- That the bidding continue if the offers presented are unsatisfactory[33].

In addition, the *Federal Courts Rules*, via Rule 492(1) enable the Court to give directions as to the procedure to be followed in determining the rights of the parties in the course of a sale under Rule 490. Based on the broad language given to the Courts in the combination of Rules 490 and 492 and a comprehensive reading of the jurisprudence relating to vessel sale, the Court has

[27] *Supra* note 26 at para 12 and 15
[28] Rule 490(1)(b)
[29] Rule 490(1)(b)(i)
[30] Rule 490(1)(d)
[31] Rule 490(1)(b)(i) and (ii)
[32] Rule 490(1)(b)(iii)
[33] Rule 490(1)(c)

ample ability to take into account multiple factors and devise a manner in which the vessel will be sold for the best price in the most expedient and cost effective manner.

Ultimately, the Court will exercise its discretion in formulating a sale procedure. It is suggested that some issues to consider include the following:

1. Is the order for sale fair and does it give the appearance of fairness to all concerned?
    a. Does it work to protect the interest of all parties, not just the arresting party or the owner?

2. Is it structured to attract a fair market value or has a fair market value already been established in the evidence before the court?

3. Does it provide an opportunity to attract bidders to offer the best price?
    a. Has there been sufficient notice and advertising of the pending sale and opportunity to respond?
    b. Are there other reasonable means in which the best price could be attracted?

4. Are the transaction costs to be anticipated reasonable in the circumstances?
    a. Will the expenditure of further costs (i.e. the use of a different ship brokerage, wider advertising etc.) increase the overall sale price and the net result?

5. Are there special circumstances that gravitate towards framing a sale order in a particular direction?

Framing of Sale Orders

Due to the myriad of options that can be exercised under Rule 490(1), the forms of sale orders can vary greatly. The following are a few points which may prove helpful in the framing of sale orders:

1. The order should provide for independent appraisal of the property, unless there has already been satisfactory evidence presented as to the fair market value or sale price which has been approved by the court.

2. The order should provide the process for identifying the buyer and settling upon the price to be paid (e.g. auction or sealed tender). In the event that the Court has approved of a pre-arranged contract of sale, the buyer should be identified. The manner of obtaining the best price for the lowest cost in a reasonable time should be considered.

3. The order should provide that, on completion of the sale, the purchaser acquires title to the property "free and clear of all liens and encumbrances." While this stipulation is not required by the rules, the effect of a judicial sale is that it rids the maritime property of all liens[34], and as such this language is typically employed in a sale order. This "cleansing" aspect of the judicial admiralty sale is the element that makes the sale most attractive from the buyer's perspective.

4. The order should provide for payment of the sale proceeds and execution and delivery of a bill of sale by the sheriff. The order should also provide for the opportunity for the declaration of other aspects necessary to give effect to the sale and commercial deployment of the vessel, such as registration of the vessel to the new owners.

III. DISTRIBUTION OF PROCEEDS OF SALE

The topic of the priority of payment in a judicial admiralty sale is beyond the scope of this paper. However, the concept will be touched upon briefly for the sake of completeness, identifying the issue and raising matters for consideration. There is little jurisprudence on the issue of the distribution of the proceeds of sale of a vessel.[35] However, from the little Canadian jurisprudence that exists, there is a seminal decision which has discussed the priority of payment in an admiralty sale. It is the 1971 decision of Justice Keirstead of the Federal Court of Canada Trial Division in *Comeau's Seafoods Limited v. Frank & Troy (The)*[36]. In *The Frank & Troy*, the Court dealt with competing claims against the sale proceeds of a vessel. The claims related to damages arising out of a collision, an unpaid account for the supplies of necessaries to a vessel and a marine mortgage. After a review of the existing jurisprudence, the Court established the order of priority of payment as follows:

1. Costs of rendering the fund available by sale of the *res*, and costs relating to establishing priorities;
2. Maritime Liens.
3. Marine Mortgages.
4. The claims of the supplier of necessaries.[37]

It has been a longstanding principle in admiralty law that the fund should be disbursed first to those that are responsible for the creation and the establishment of the fund from which all of the creditors will benefit. Thereafter, the other creditors will be entitled depending on the class of

[34] Rule 490 (3).
[35] It should be noted that this deals only with the proceeds of sale following a sale under Rule 490, and not with the distribution of bail or other security provided in place of the arrested property.
[36] [1971] F.C. 556
[37] *Supra* note 36 at para. 35.

creditor or claim in which they fall. The manner in which competing interests within the same level of claim (i.e. two claims of the same level or class) is a detailed subject beyond this paper's scope.

It is suggested that the general order of payment from the proceeds of the admiralty sale should be as follows:

1. Costs and expenses of the sale of the vessel to create the fund (i.e. the ship broker's commission, advertising costs and related expenses to facilitate the sale). It is submitted that this should come first in priority as it was necessary to incur these expenses to liquidate the asset into a fund that can be shared by all.
2. The costs of maintaining the vessel while under arrest (as opposed to the costs of maintaining the vessel itself) such as berthage expenses or the expenses for the maintenance of the arrest of the vessel from the period when the arrest began until it was sold. These are expenses that are incurred while the vessel is "in *custodia legis"* and serve to benefit all of the parties interested in the sale of the vessel.
3. The legal costs of the party arresting the vessel for their costs and expenses incurred in arresting the vessel. It is suggested that it would be inequitable that the party that expended money to affect the arrest should not be reimbursed for those expenses related to the arrest since they served to benefit all claimants.
4. Maritime Liens or the liens that survive changes in ownership of the vessel. These claims "run" with the vessel.
5. Possessory Liens existing at the time of the arrest.
6. Marine mortgages.
7. Claims arising as a result of rights in *rem* also known as statutory liens, which run from the date of arrest.

IV. WRONGFUL ARREST

I conclude this paper with a few comments on wrongful arrest. The concept is basically that the plaintiff took steps to arrest maritime property which was subsequently released from arrest due to a deficiency in the arrest or the claim was unproven following a trial on the merits. The defendant, who had its property (wrongfully) arrested may be sufficiently aggrieved by the arrest and seek damages from the plaintiff. In order for a party to obtain damages for wrongful arrest, it must prove that the arrest was done with malice or gross negligence.

The law in Canada on the issue of wrongful arrest is set out in *Armada Lines Ltd. v. Chaleur Fertilizers Ltd* ("*Armada Lines*")[38]. The plaintiff contracted with the defendant to transport the defendant's cargo of fertilizer from New Brunswick to Togo. According to the agreement, the

[38] [1997] 2 S.C.R. 617

defendant was to have its cargo ready for loading by March 30. The defendant had problems with its supplier and the cargo was not presented for loading until April 9.

The plaintiff commenced an action *in rem* against the cargo and an action *in personam* against the defendant, alleging breach of contract. The plaintiff arrested the cargo, and security was posted by the defendant in the amount of $80,000.00. The defendant counterclaimed for damages arising out of the arrest of the cargo of fertilizer, including loss of interest for posting of security and loss of use of working capital. At trial, the plaintiff was successful in its claim for breach of contract but the defendant's counterclaim was dismissed.

The defendant appealed. The Federal Court of Appeal[39] dismissed the breach of contract action and awarded the defendant damages for wrongful arrest of the cargo. The plaintiff appealed to the Supreme Court of Canada.

The Supreme Court of Canada found that the Court of Appeal had awarded damages to the defendant on the finding that the plaintiff had arrested the cargo "without legal justification", when in fact the standard that is required for a damages award is that the arrest must amount to malice or gross negligence. This rule was laid down in *The* "*Evangelismos*"[40], an English case from 1858.

In *The "Evangelismos"*, a "strange vessel" had collided with the brig the "Hind", and disappeared. The appearance of the Evangelismos coincided with that of the strange vessel and as a result, the Evangelismos was arrested by the owners of the Hind. The Admiralty Court held that there was insufficient evidence to find that Evangelismos was the vessel that had collided with the Hind. Consequently, the owner of the Evangelismos applied to the court for damages and losses sustained in consequence of Evangelismos' arrest. The Privy Council held that a court could only award damages for wrongful arrest where the arresting party acts with either bad faith (malice) or gross negligence:

> Undoubtedly there may be cases in which there is either mala fides, or that crassa negligentia, which implies malice, which would justify a Court of Admiralty giving damages…
>
> The real question in this case, following the principles laid down with regard to actions of this description, comes to this: is there or is there not, reason to say, that the action was so unwarrantably brought, or brought with so little colour, or so little foundation, that it rather implies malice on the part of the Plaintiff, or that gross negligence which is equivalent to it?[41]

[39] [1994] F.C.J. No. 1074
[40] 14 E.R. 945
[41] *Supra* note 40 at p. 948

This test as set out in *The "Evangelismos"* was affirmed and adopted by the Supreme Court of Canada in *Armada Lines*. The defendant urged the Court to depart from the rule, but the Court declined to do so on the grounds that such a change falls to the legislature, and not the courts, to carry out.

Since 1997 when *Armada Lines* was decided, there has been no change in the law and the requirement that there be conduct amounting to malice or gross negligence for damages for wrongful arrest remains good law in Canada.